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Covenants Not to Sue Provide less Immunity in a Post-MedImmune World

Edo Royker

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Notes

Covenants Not to Sue Provide Less Immunity in a Post-MedImmune World

EDO ROYKER*

The primary focus of this Note is to address the impact of the totality of circumstances test, as now adopted by the Federal Circuit, on covenants not to sue. Under the old reasonable apprehension test, promises not to sue were given greater weight than under the new totality of the circumstances test. Part I of this Note will address the new totality of the circumstances test under MedImmune and SanDisk. Part II of this Note will begin by analyzing the application of promises not to sue prior to the MedImmune and SanDisk decisions and then compare the weight given to the same promises in a post-MedImmune world. Although the current case law does not indicate an extreme change from the pre-MedImmune decisions, the dicta in these cases indicates that a more extreme change may be forthcoming. Finally, Part III will respond to a number of scholarly articles that have indicated disapproval of the Federal Circuit's application of the totality of the circumstances test and explain why such criticism may be called for in certain situations but not in others. More specifically, Part III will explore four potential bargaining scenarios between hypothetical licensors and licensees, and will apply a twofold analysis taking into account exposed revenue and burdensome litigation costs. The article concludes that if the primary purpose of a company is to develop technology, rather than to generate revenue through an aggressive licensing plan, then the new declaratory judgment standard will help such companies operate without fear of faulty license demands.

* J.D. Candidate, University of California, Hastings College of the Law, 2010; B.S., University of Southern California, 2007. I would like to thank my mother for always providing a nurturing environment and teaching me that a little can be a lot.

TABLE OF CONTENTS

INTRODUCTION.....	474
I. <i>MEDIMMUNE</i> AND <i>SANDISK</i> ALTER THE LANDSCAPE OF ACTUAL CONTROVERSIES IN THE PATENT CONTEXT.....	476
II. COVENANTS NOT TO SUE: BEFORE AND AFTER <i>MEDIMMUNE</i>	477
A. INTRODUCTION TO COVENANTS NOT TO SUE	477
B. COVENANTS NOT TO SUE BEFORE <i>MEDIMMUNE</i>	479
C. COVENANTS NOT TO SUE AFTER <i>MEDIMMUNE</i>	481
D. ADVOCATING A BROAD TOTALITY OF THE CIRCUMSTANCES TEST FOR PIPELINE PRODUCTS.....	486
III. THE NEW DECLARATORY JUDGMENT STANDARD AND ITS IMPACT ON LICENSING AGREEMENTS	490
A. PURIFYING THE PATENT SYSTEM OF INVALID PATENTS	490
B. FOUR BARGAINING SCENARIOS: AN ANALYSIS OF BOTH EXPOSED REVENUES AND BURDENSOME LITIGATION COSTS	491
CONCLUSION	495

INTRODUCTION

The Declaratory Judgment Act¹ provides courts with Article III jurisdiction to “declare the rights and other legal relations of any interested party seeking such declaration” in “cases of actual controversy.”² The purpose of the Declaratory Judgment Act is to provide certainty to parties who believe that their conduct may subject them to litigation.³ Not surprisingly, the most controversial component in analyzing a declaratory judgment action is whether or not an actual controversy exists.

The difficulty in determining the existence of an actual controversy is even more pronounced in the patent infringement context, as illustrated by the Supreme Court’s rejection of the Federal Circuit’s reasonable-apprehension test.⁴ Until recently, the Federal Circuit applied a two-part test to determine the existence of an actual controversy that focused on the conduct of both the patentee and the alleged infringer.⁵ Under this two-part test, an actual controversy exists if there is both

1. 28 U.S.C. §§ 2201–2202 (2006).

2. *Id.* § 2201(a); see U.S. CONST. art. III, § 2.

3. *BP Chemicals Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 977 (Fed. Cir. 1993) (explaining that the purpose of the declaratory judgment act is to enable a person who is at legal risk because of an unresolved issue to obtain resolution of the issue without waiting for the other side to initiate litigation).

4. See *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 132 n.11 (2007).

5. *Teva Pharm. USA, Inc. v. Pfizer, Inc.*, 395 F.3d 1324, 1330 (Fed. Cir. 2005).

(1) . . . explicit threat or other action by the patentee which creates a reasonable apprehension on the part of the declaratory judgment plaintiff that it will face an infringement suit, and (2) present activity by the declaratory judgment plaintiff which could constitute infringement, or concrete steps taken by the declaratory judgment plaintiff with the intent to conduct such activity.⁶

In the dicta of footnote 11 of the *MedImmune, Inc. v. Genentech, Inc.* decision, the Supreme Court criticized the reasonable-apprehension test adopted by the Federal Circuit.⁷ Instead the Court followed a totality of the circumstances test that focuses on the adverse legal interests of the two parties.⁸ The Federal Circuit has since applied the totality of the circumstances test in the pivotal *SanDisk Corp. v. STMicroelectronics* case,⁹ which indicates that the Federal Circuit has interpreted the *MedImmune* decision to require a totality of the circumstances analysis for declaratory judgment actions in all patent suits. In finding that an actual controversy under Article III existed, the Federal Circuit held that a promise by the declaratory judgment defendant not to sue did not eliminate an actual controversy.¹⁰

The primary focus of this Note is to address the impact of the totality of circumstances test, as now adopted by the Federal Circuit, on covenants not to sue.¹¹ Under the old reasonable-apprehension test, promises not to sue were given greater weight than under the new totality of the circumstances test.¹² Part I of this Note addresses the new totality of the circumstances test under *MedImmune* and *SanDisk*.¹³ Part II of this Note begins by analyzing the application of promises not to sue prior to the *MedImmune* and *SanDisk* decisions and then compares the weight given to the same promises in a post-*MedImmune* world. Although the current case law does not indicate an extreme change from

6. *Id.*

7. 549 U.S. at 132 n.11.

8. *Id.* at 127 (quoting *Md. Cas. Co. v. Pac. Coal & Oil Co.*, 312 U.S. 270, 273 (1941)).

9. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1381–82 (Fed. Cir. 2007).

10. *Id.* at 1382–83.

11. This Note does not distinguish between covenants not to sue and promises not to sue, and will treat the two identically. The equal treatment of these two instruments seems fair in light of the Federal Circuit treating promises not to sue and covenants not to sue as equally enforceable in certain situations. See *Super Sack Mfg. Corp. v. Chase Packaging Corp.*, 57 F.3d 1054, 1059 (Fed. Cir. 1995). Additionally, *Black's Law Dictionary* fails to provide a definition for a promise not to sue and defines a covenant to sue as “[a] covenant in which a party having a right of action agrees not to assert that right in litigation.” BLACK’S LAW DICTIONARY 391 (8th ed. 2004). *Black’s* then references JOHN D. CALAMARI & JOSH M. PERILLO, THE LAW OF CONTRACTS §21-11, at 878–79 (3d ed. 1987), explaining that a “covenant not to sue is a promise by the creditor not to sue either permanently or for a limited period.” See BLACK’S LAW DICTIONARY, *supra*, at 391. By defining a covenant not to sue as a promise not to sue, *Black’s Law Dictionary* further supports an equal treatment of both instruments.

12. See *infra* Part II.B.

13. See *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007).

the pre-*MedImmune* decisions, the dicta in these cases indicate that a more extreme change may be forthcoming.¹⁴ Finally, Part III responds to a number of scholarly articles that have indicated disapproval of the Federal Circuit's application of the totality of the circumstances test¹⁵ and explains why such criticism may be appropriate in certain situations but not in others.

I. *MEDIMMUNE* AND *SANDISK* ALTER THE LANDSCAPE OF ACTUAL CONTROVERSIES IN THE PATENT CONTEXT

In *MedImmune v. Genentech*, the Supreme Court addressed whether an actual controversy existed even if the declaratory judgment plaintiff was still paying licensing fees to the declaratory judgment defendant.¹⁶ In prior cases, the Federal Circuit had held that continuation of license payments prevented a plaintiff from having a "reasonable apprehension of a lawsuit" and thus an actual controversy as required under Article III.¹⁷ The Supreme Court's *MedImmune* decision marked a momentous change in the patent licensing framework.¹⁸ Justice Scalia stated that a declaratory judgment plaintiff may bring a suit even if the plaintiff continues to make licensing payments because it is unreasonable to make "the plaintiff bet the farm, so to speak, by taking the violative action" of ceasing to make licensing payments.¹⁹ Justice Scalia went even further in footnote 11 of the *MedImmune* opinion, where he criticized the Federal Circuit's reasonable-apprehension test.²⁰

Following the *MedImmune* decision, the Federal Circuit discarded its reasonable-apprehension test and held that "[t]he Supreme Court's opinion in *MedImmune* represents a rejection of our reasonable apprehension of suit test."²¹ The Federal Circuit stated:

We need not define the outer boundaries of declaratory judgment jurisdiction, which will depend on the application of the principles of declaratory judgment jurisdiction to the facts and circumstances of each case. We hold only that where a patentee asserts rights under a patent based on certain identified ongoing or planned activity of

14. See *infra* Part II.C, D.

15. See, e.g., Katherine A. Helm & Gene W. Lee, *Call It a Comeback: A Sweeping Change in the Law on Declaratory Judgment Actions Against Patent Owners*, 64 N.Y.U. ANN. SURV. AM. L. 231 (2008); Jennifer R. Saionz, Note, *Declaratory Judgment Actions in Patent Cases: The Federal Circuit's Response to MedImmune v. Genentech*, 23 BERKELEY TECH. L.J. 161 (2008).

16. 549 U.S. at 120–21.

17. *Gen-Probe Inc. v. Vysis, Inc.*, 359 F.3d 1376, 1381 (Fed. Cir. 2004) (citing *Fina Research, S.A. v. Baroid Ltd.*, 141 F.3d 1479, 1483–84 (Fed. Cir. 1998); *Super Sack Mfg. Corp. v. Chase Packaging Corp.*, 57 F.3d 1054, 1058 (Fed. Cir. 1995)).

18. See Saionz, *supra* note 15, at 192.

19. *MedImmune*, 549 U.S. at 129.

20. *Id.* at 132 n.11.

21. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1380 (Fed. Cir. 2007).

another party, and where that party contends that it has the right to engage in the accused activity without license, an Article III case or controversy will arise and the party need not risk a suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights.²²

The language of *SanDisk* does not establish the outer boundaries of what would suffice for a declaratory judgment action.²³ However, the Federal Circuit indicated that the analysis must focus on the adverse interests of the parties as indicated by the conflicting rights asserted by the parties.²⁴ According to the new standard, actual infringement on the part of the declaratory judgment plaintiff is unnecessary, rather, even “planned activity” may constitute grounds for finding an actual controversy.²⁵

The concurring opinion of *SanDisk* went so far as to say that it would appear that under the court’s standard virtually any invitation to take a paid license relating to the prospective licensee’s activities would give rise to an Article III case or controversy if the prospective licensee elects to assert that its conduct does not fall within the scope of the patent. Indeed, as the court makes clear, *even a representation by the patentee that it does not propose to file suit against the prospective licensee will not suffice to avoid the risk that the patentee will face a declaratory judgment action.*²⁶

The concurrence further stated that this new application of the rule would cause a “sweeping change” in the law.²⁷ Under the new standard, the balance of power has greatly shifted from the licensor to the licensee because the licensee may seek a declaratory judgment against the licensor to prove patent invalidity or noninfringement.²⁸ As the concurring opinion indicates, even a promise not to sue provides less immunity in this post-*MedImmune* world.²⁹

II. COVENANTS NOT TO SUE: BEFORE AND AFTER *MEDIMMUNE*

A. INTRODUCTION TO COVENANTS NOT TO SUE

To establish jurisdiction under a declaratory judgment action, “[a]n actual controversy must be extant at all stages of review, not merely at the time the complaint is filed.”³⁰ This implies that if the actual

22. *Id.* at 1381.

23. *See id.*

24. *See id.* at 1382.

25. *Id.* at 1381.

26. *Id.* at 1384 (Bryson, J., concurring in the result) (emphasis added).

27. *Id.* at 1385.

28. *See Saionz, supra* note 15, at 192.

29. *See SanDisk*, 480 F.3d at 1384 (Bryson, J., concurring).

30. *Amana Refrigeration, Inc. v. Quadlux, Inc.*, 172 F.3d 852, 855 (Fed. Cir. 1999) (quoting

controversy is destroyed by some future action then the court may lose subject matter jurisdiction over the issue. In a number of cases, covenants not to sue have successfully destroyed the actual controversy and limited the courts' declaratory judgment jurisdiction.³¹ The interesting facet of this legal trend is the effect of the new declaratory judgment standard on covenants not to sue in future court decisions. Specifically, covenants not to sue seem to be at the intersection of the two prongs of the old Federal Circuit test. A covenant not to sue implicates both (1) the old reasonable-apprehension prong, and (2) the actually-infringing-activity prong necessary for an actual controversy.³² Numerous scholars have indicated that the new declaratory judgment standard will enable more declaratory judgment suits because of its rejection of the reasonable-apprehension prong as previously applied by the Federal Circuit.³³ However, these scholars have not addressed the implication of the new declaratory judgment standard on covenants not to sue.³⁴

The following sections include a fact-intensive exploration of important declaratory judgment cases involving covenants not to sue while applying the reasonable-apprehension test (pre-*MedImmune*) and compare them to more recent decisions applying the totality of the circumstances test (post-*MedImmune*). I will argue that although the post-*MedImmune* decisions would have likely been decided in a similar manner even under the pre-*MedImmune* standard, the factual scenarios in the post-*MedImmune* cases were such that they required a similar result under both standards.³⁵ However, I will also argue that the dicta in these post-*MedImmune* cases indicate that under certain factual scenarios, a different decision would result under the reasonable-apprehension standard than would result under the totality of the circumstances test. Furthermore, I will explain that under certain factual scenarios, a covenant not to sue provides less protection under the new totality of the circumstances test, which will lead to, as scholars have predicted,³⁶ a more lax standard for declaratory judgment. Finally, in Part III of this Note, I will explain why, contrary to some scholars' opinions,³⁷

Preiser v. Newkirk, 422 U.S. 395, 401 (1975)); see also Benitec Austl., Ltd. v. Nucleonics, Inc., 495 F.3d 1340, 1345 (Fed. Cir. 2007) (quoting Steffel v. Thompson, 415 U.S. 452, 459 n.10. (1974)).

31. See, e.g., Samsung Elecs. Co. v. Rambus, Inc., 398 F. Supp. 2d 470, 476 (E.D. Va. 2005).

32. *SanDisk*, 480 F.3d at 1379.

33. See, e.g., Helm & Lee, *supra* note 15, at 246.

34. See *id.*

35. See generally Michael A. Ladra & Lillian Ewing, *Declaratory Judgment Practices After SanDisk v. STMicroelectronics*, 24 SANTA CLARA COMPUTER & HIGH TECH. L.J. 185 (2007) (explaining that little has changed following *MedImmune*).

36. See, e.g., Saionz, *supra* note 15, at 192.

37. See *id.*; see also Helm & Lee, *supra* note 15, at 246.

the more lax declaratory judgment standard will ensure a more competitive environment for smaller companies and limit the troll-like antics of license-holding companies.

B. COVENANTS NOT TO SUE BEFORE *MEDIMMUNE*

In the 1995 Federal Circuit decision *Super Sack Manufacturing Corp. v. Chase Packaging Corp.*, the court held that a promise not to sue divested the court of subject matter jurisdiction by eliminating a present controversy.³⁸ Super Sack had initially asserted its patent rights against Chase, but then subsequently made a promise not to sue Chase for any past or present infringements or for identical products to the ones sold at that time.³⁹ The Federal Circuit stated that the “second part of our test of declaratory justiciability respecting patent rights requires that the putative infringer’s ‘present activity’ place it at risk of infringement liability.”⁴⁰ The court specifically explained that by promising not to assert its patent rights against the past and present activity of Chase, Super Sack had eliminated Chase’s risk of infringement liability.⁴¹ The court maintained this reasoning despite Chase’s argument that Super Sack’s promise only covered Chase’s past and present activity, but not its future activity.⁴² Chase argued that an actual controversy existed because the promise not to sue did not cover Chase’s future activity.⁴³ However, the Federal Circuit held that “[t]he residual possibility of a future infringement suit based on Chase’s future acts is simply too speculative a basis for jurisdiction.”⁴⁴

The Federal Circuit further explained that Chase did not assert any future planned activity,⁴⁵ which would distinguish this case from a later case, *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*,⁴⁶ on the facts. However, the court stated that “Super Sack’s promise not to sue renders any past or present acts of infringement that Chase may or may not have committed irrelevant to the question whether a justiciable controversy remains.”⁴⁷ This statement connotes that even if Chase conducted past acts in preparation of future sales, this evidence would be irrelevant to

38. 57 F.3d 1054, 1059 (Fed. Cir. 1995).

39. *Id.* at 1056.

40. *Id.* at 1059 (quoting *BP Chems. Ltd. v. Union Carbide Corp.*, 4 F.3d 975, 978 (Fed. Cir. 1993)).

41. *Id.*

42. *Id.* at 1059–60.

43. *Id.* at 1059.

44. *Id.* at 1060.

45. *Id.* at 1059–60.

46. 556 F.3d 1294, 1295–96 (Fed. Cir. 2009) (holding that an actual controversy existed because of Revolution’s planned future activity). This case is discussed in greater depth at footnotes 80–96 and accompanying text.

47. *Super Sack*, 57 F.3d at 1060.

the question of the existence of a justiciable controversy, since the court must focus on present infringing activity.⁴⁸ Under this line of reasoning, even if Chase had conducted past activity in preparation of some future infringing act (e.g., building a manufacturing plant that would make infringing products), this past activity would not be indicative of an actual controversy, since *Super Sack*'s promise rendered any past or present acts of Chase "irrelevant to the question whether a justiciable controversy remains."⁴⁹ Therefore, although the facts in *Super Sack* differ from those in *Revolution* and may explain the different results of the two cases, a juxtaposition of the dicta from the two cases reveals their inconsistency.

Four years after the *Super Sack* decision, the Federal Circuit revisited covenants not to sue in the declaratory judgment context in *Amana Refrigeration, Inc. v. Quadlux, Inc.*⁵⁰ This case demonstrates an even more pronounced difference between the old reasonable-apprehension test and the new post-*MedImmune* standard. As will be explained later, the *Amana* case, unlike the *Super Sack* decision, would have likely been decided differently in the post-*MedImmune* world.⁵¹ After unsuccessful licensing negotiations, Quadlux asserted that Amana infringed its '005 patent and sent a warning letter to Amana indicating that it was in violation of the patent and that Quadlux would enforce its rights.⁵² Additionally, Quadlux terminated its contractual relationship with three distributors because they were also associated with Amana.⁵³ Quadlux indicated to these distributors that Amana was going to proceed to make a copy of Quadlux's oven and, therefore, Quadlux was terminating its contractual relationship with these distributors.⁵⁴ In response to the warning letter and other actions by Quadlux, Amana filed a declaratory judgment suit in federal court alleging noninfringement and patent invalidity of Quadlux's patent.⁵⁵ Quadlux then filed a declaration by its president and CEO that it would not assert its patent rights for past or present activity of Amana that may have been infringing activity.⁵⁶

48. *See id.* at 1059.

49. *Id.* at 1060.

50. 172 F.3d 852, 855 (Fed. Cir. 1999).

51. *See infra* Part II.D.

52. *Amana*, 172 F.3d at 854-55.

53. *Id.* at 855.

54. *Id.*

55. *Id.*

56. *Id.* ("Quadlux filed a . . . declaration . . . covenanting not to 'assert any claim of patent infringement against Amana under [the '005 patent] as it presently reads, with respect to any product currently advertised, manufactured, marketed or sold by Amana, or any product which was advertised, manufactured, marketed or sold by Amana prior to the date of this declaration.'" (third alteration in

The Federal Circuit affirmed the trial court's dismissal of Amana's declaratory judgment suit for lack of subject matter jurisdiction.⁵⁷ Despite Amana's contention "that the Quadlux covenant did not remove Amana's reasonable apprehension of being sued with regard to its new products 'in the pipeline,' but not advertised, manufactured, marketed, or sold before the filing date,"⁵⁸ the Federal Circuit, citing the *Super Sack* decision, affirmed the notion "that a covenant not to sue for any infringing acts involving products 'made, sold, or used' on or before the filing date is sufficient to divest a trial court of jurisdiction over a declaratory judgment action."⁵⁹ The court explained that an actual controversy must be extant at all stages of litigation, and that in this situation, as in *Super Sack*, the actual controversy had been eliminated by the Quadlux covenant.⁶⁰ Therefore, the court held that Amana's potentially infringing "pipeline" products were "too speculative a basis" for determining whether an actual controversy existed.⁶¹

This case, even more substantially than *Super Sack*, highlights the basic doctrine of the reasonable apprehension test. Under the reasonable-apprehension standard, the actual controversy was viewed as entirely eliminated if the covenant not to sue covered all current products.⁶² However, this type of policy puts the allegedly-infringing party into a difficult situation. The patent-holding party can merely craft a covenant not to sue the alleged infringer for current and past activity and thus destroy jurisdiction on the current issue. The patent holder can then wait and reassert its patent rights against the alleged infringer's future products that were in the pipeline. The new totality of the circumstances test may help the alleged infringer avoid this type of situation. Before diving into the policy ramifications of the new rule, it is important to look at the Federal Circuit decisions following the *MedImmune* decision and to consider how the court has applied the new rule differently from the prior cases just discussed.

C. COVENANTS NOT TO SUE AFTER *MEDIMMUNE*

This section will explore three important Federal Circuit decisions following the *MedImmune* decision that also involve covenants not to

original)).

57. *Id.* at 857.

58. *Id.* at 855.

59. *Id.* (citing *Super Sack Mfg. Corp. v. Chase Packaging Corp.*, 57 F.3d 1054, 1060 (Fed. Cir. 1995)).

60. *Id.* (citing *Preiser v. Newkirk*, 422 U.S. 395, 401 (1995)).

61. *Id.* at 855-56.

62. *See Super Sack*, 57 F.3d at 1059.

sue. The first of these decisions is the *SanDisk* decision,⁶³ in which the Federal Circuit demonstrated its affirmation and interpretation of the Supreme Court's *MedImmune* decision. The next case addressed is *Benitec Australia, Ltd. v. Nucleonics, Inc.*, which also involves a covenant not to sue.⁶⁴ Finally, this section will address the most recent covenant not to sue patent case, *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*,⁶⁵ and the important dicta contained within it.

The *SanDisk* decision is the Federal Circuit's first application of the new declaratory judgment test following the *MedImmune* decision.⁶⁶ Although not the main focus of the decision, STMicroelectronics argued that its promise not to sue SanDisk defeated declaratory judgment jurisdiction.⁶⁷ The Federal Circuit, applying the new *MedImmune* standard, concluded that STMicroelectronics's "statement that it does not intend to sue does not moot the actual controversy created by its acts."⁶⁸ The court did not explore the details of the promise not to sue, but rather focused on the multiple meetings and negotiations between the two parties.⁶⁹ Even though STMicroelectronics provided a promise not to sue to SanDisk, the totality of the circumstances indicated that an actual controversy still existed.⁷⁰ This type of analysis is to some extent in conflict with the analyses in *Amana* and *Super Sack* because the court shifts its focus of analysis to additional factors and not just the promise not to sue. However, *SanDisk* would have likely been decided in the same fashion even under the old reasonable-apprehension test.⁷¹ The Federal Circuit later explained its decision in *SanDisk* by clarifying that the promise not to sue in SanDisk "only stated that it did not *intend* to sue SanDisk; it did not say it *would not* sue SanDisk in the future for its alleged infringement."⁷² Nonetheless, *SanDisk* represents a marked

63. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1383 (Fed. Cir. 2007).

64. 495 F.3d 1340, 1343 (Fed. Cir. 2007).

65. 556 F.3d 1294 (Fed. Cir. 2009).

66. *See supra* Part I.

67. *SanDisk*, 480 F.3d at 1383.

68. *Id.* (citing *Md. Cas. Co. v. Pac. Coal & Oil Co.*, 312 U.S. 270, 273 (1941)).

69. *Id.* at 1382.

70. *See id.* at 1383. The court provided a number of factors that it said should be considered when viewing the totality of the circumstances. *See id.* at 1378. However, the most important factor was the multiple meetings between the two parties. *See id.* at 1382.

71. In *SanDisk*, STMicroelectronics made the unequivocal statement that it had "absolutely no plan whatsoever to sue SanDisk." *Id.* The court held that STMicroelectronics's "statement that it does not intend to sue does not moot the actual controversy created by its acts." *Id.* at 1383 (citing *Md. Cas. Co.*, 312 U.S. at 273). Although this important dicta indicates a marked change from the reasonable-apprehension test, it may be that the lack of specificity in the promise not to sue made it less binding and thus prevented the promise from mooting the controversy.

72. *Benitec Austl. Ltd. v. Nucleonics, Inc.*, 495 F.3d 1340, 1347 (Fed. Cir. 2007).

change in the analysis of declaratory judgment cases and the relevant role of promises not to sue in finding an actual controversy.

Another recent case indicating the lack of change between the pre- and post-*MedImmune* standards is *Benitec Australia v. Nucleonics*. In this case, Nucleonics was developing RNAi medication for treating Hepatitis B, and the new technology allegedly infringed Benitec's patent.⁷³ The court noted that "[i]n its appellee's brief, Benitec 'covenants and promises not to sue Nucleonics for patent infringement arising from activities and/or products occurring on or before the date dismissal was entered in this action'"⁷⁴ The court held that a controversy did not arise because the covenant not to sue covered any infringing activity, and because Nucleonics' research was acceptable under a statutory exception.⁷⁵ Nucleonics further contended that even if its research for a human drug was covered by a statutory exception, Nucleonics intended to conduct animal testing and develop animal products using the same technology.⁷⁶ Nucleonics argued that this type of activity would be infringing and that an actual controversy existed.⁷⁷ The Federal Circuit concluded that this was not sufficient evidence of an actual controversy because: (1) there was no direct evidence of Nucleonics conducting animal research and therefore it was too speculative, (2) the research might be covered under a statutory exception, and (3) the covenant not to sue covered an infringing activity that may have caused an actual controversy.⁷⁸ Interestingly, the dissent noted the following:

Benitec stated that it would not sue "for any research that was going on prior to the dismissal" or "for animal research that was done at the time of the dismissal." Notably, Benitec offered no covenant with respect to future human or animal products or animal research.

The majority holds that Nucleonics has the burden of demonstrating a continuing case or controversy as narrowed by Benitec's promises.⁷⁹

Ultimately, Benitec did not succeed in showing an actual controversy, thus demonstrating a limited departure on declaratory judgment jurisdiction.

On February 13, 2009, the Federal Circuit decided *Revolution Eyewear v. Aspex Eyewear*, which is the most recent Federal Circuit decision addressing covenants not to sue in the declaratory judgment

73. *Id.* at 1342; see Andrew Fire et al., *Potent and Specific Genetic Interference by Double-Stranded RNA in Caenorhabditis Elegans*, 391 NATURE 806 (1998) (explaining RNA interference ("RNAi")).

74. *Benitec*, 495 F.3d at 1343.

75. *Id.* at 1346.

76. *Id.* at 1348.

77. *Id.*

78. *Id.* at 1348-49.

79. *Id.* at 1352 (Dyk, J., dissenting).

context.⁸⁰ The court correctly applied the totality of the circumstances test, and although it may have been decided similarly under the reasonable-apprehension test, the dicta in the case clearly indicate a departure from the past standards in the covenant not to sue arena. In the *Revolution* case, Revolution sued Aspex for infringing its eyeglasses patent.⁸¹ Aspex then filed a declaratory judgment suit for noninfringement against Revolution.⁸² In an attempt to settle the issue and destroy the actual controversy necessary for jurisdiction under a declaratory judgment action, Revolution signed a covenant not to sue with Aspex.⁸³ The covenant stated that Revolution would not sue Aspex for past or present infringement; however, the covenant did not extend to future activity or to continued production of current products.⁸⁴ Not covering resumed production of current products was detrimental to Revolution's claim because, in this particular situation, Aspex intended to resume production of glasses that allegedly infringed Revolution's patent.⁸⁵ Therefore, if Aspex decided to sell these glasses at a later point (which it intended to do), it would infringe the Revolution patent and subject itself to further litigation.⁸⁶

The Federal Circuit explained that "Aspex's declaratory action is not a request for an 'advisory opinion' sought by a would-be future competitor; it meets the *MedImmune* requirement of 'sufficient immediacy and reality,' when the entirety of the circumstances are considered."⁸⁷ This ruling distinguishes the case from other cases in which the Federal Circuit had found that covenants not to sue destroyed declaratory judgment jurisdiction.⁸⁸ Therefore, one could argue that the only reason the case was decided differently from the pre-*MedImmune* decisions is because the *Revolution* covenant did not cover resumed production of current products, which therefore maintained the immediacy of the controversy. As will be explained below, although this is an accurate and important point, the post-*MedImmune* standard likely did have an impact on the *Revolution* decision.

80. *Revolution Eyewear, Inc. v. Aspex Eyewear, Inc.*, 556 F.3d 1294, 1295 (Fed. Cir. 2009).

81. *Id.*

82. *Id.*

83. *Id.* at 1295-96.

84. *See id.* at 1296 ("Revolution and counter-defendant Gary Zelman hereby unconditionally covenant not to sue Aspex for patent infringement under the '913 patent based upon any activities and/or products made, used, or sold on or before the dismissal of this action (03-5965 case).").

85. *Id.*

86. *Id.*

87. *Id.* at 1299 (citation omitted) (quoting *MedImmune, Inc. v. Genentech, Inc.* 549 U.S. 118, 127 (2007)).

88. *See, e.g., Samsung Elecs. Co. v. Rambus, Inc.*, 398 F. Supp. 2d 470, 476 (E.D. Va. 2005).

The impact of the new totality of the circumstances test first comes to light in the dicta of the *Revolution* decision. The Federal Circuit began by explaining that even in the post-*MedImmune* world, an “actual controversy must be extant at all stages of review.”⁸⁹ However, the court then further explained that the *MedImmune* decision

did change the Federal Circuit’s rule that there must be either actual infringement or active preparation to infringe accompanied by a reasonable apprehension of imminent suit, for those circumstances were not present on the facts of *MedImmune*. Instead, the Court imposed a totality-of-the-circumstances test for deciding whether there is indeed an actual controversy, on the particular facts and relationships involved.⁹⁰

The implications of this statement may seem subtle at first, but they have important ramifications in the context of promises not to sue. In *Revolution*, the covenant not to sue had eliminated Aspex’s “reasonable apprehension of imminent suit” because Aspex was not currently manufacturing the infringing product.⁹¹ Therefore, at the point that *Revolution* signed the covenant, there was not an imminent fear of suit, since Aspex was not currently producing the glasses. However, the court rightfully decided that even though Aspex was not currently producing the glasses, there was still an actual controversy in light of the totality of the circumstances.⁹² The court explained that Aspex intended to resume production of the infringing glasses and that the covenant not to sue did not cover the current products.⁹³ Additionally, the court also explained that the interaction between the two parties—they were in ongoing infringement litigation—must also be considered.⁹⁴ Thus, the totality of the circumstances raised an actual controversy, even though there was no fear of imminent suit at the time the covenant not to sue was signed by *Revolution*.⁹⁵

One could argue that under the facts of *Revolution*, an actual controversy would also have been found under the reasonable-apprehension test, since the resumption of glasses production by Aspex was not speculative.⁹⁶ However, the Federal Circuit has not adopted this reasoning. Furthermore, even if the Federal Circuit would have reached a similar result under the facts of *Revolution*, the dicta of *Revolution*

89. *Revolution*, 556 F.3d at 1297.

90. *Id.*

91. *Id.*

92. *Id.* at 1300.

93. *Id.* at 1298.

94. *Id.* at 1299.

95. *Id.* at 1300.

96. *But see* Benitec Austl. Ltd. v. Nucleonics, Inc., 495 F.3d 1340, 1348 (Fed. Cir. 2007).

indicate that different considerations are at play under the new totality of the circumstances test.

In conclusion, the post-*MedImmune* decisions involving a promise not to sue have so far had factual scenarios that could have been decided similarly under both the pre- and post-*MedImmune* standards. However, the dicta in the post-*MedImmune* decisions indicate that a different analysis now follows whenever the Federal Circuit addresses declaratory judgments and that this different reasoning applies equally in the context of covenants not to sue.⁹⁷

D. ADVOCATING A BROAD TOTALITY OF THE CIRCUMSTANCES TEST FOR PIPELINE PRODUCTS

This section begins by reviewing the facts of the *Amana* case and explaining why a different result may have ensued under the post-*MedImmune* totality of the circumstances standard. The post-*MedImmune* decisions have not made a marked departure from the pre-*MedImmune* decisions, at least in the covenant not to sue context. However, the similar results—despite the two differing standards—are most likely a result of the differing factual scenarios of the cases, not continued adherence to the old test. One can view the change in the declaratory judgment landscape by looking at the dicta in the decisions.⁹⁸ Under the new totality of the circumstances test, a covenant not to sue can still eliminate an actual controversy, but now this outcome is more difficult to obtain because additional factors must also be taken into account. In *Amana*, prior to the *MedImmune* decision, the Federal Circuit held that an actual controversy had been eliminated because the

97. For example, the dissent in *Benitec* explained that the majority incorrectly applied the totality of the circumstances test. *Id.* at 1355 (Dyk, J., dissenting) (“The effect of today’s decision is to limit the availability of declaratory jurisdiction to challenge invalid and unenforceable patents by allowing patentees to moot such controversies by dismissing the original infringement action and covenanting not to bring suit on existing products, without any showing that the controversy will not recur in the future.”).

98. Compare *Amana Refrigeration Corp. v. Quadlux, Inc.*, 172 F.3d 852, 855 (Fed. Cir. 1999) (“*Amana* argues that the *Quadlux* covenant did not remove *Amana*’s reasonable apprehension of being sued with regard to its new products ‘in the pipeline,’ but not advertised, manufactured, marketed, or sold before the filing date. However, an actual controversy cannot be based on a fear of litigation over future products.”), with *Revolution*, 556 F.3d 1294, 1299 (“*Revolution*’s proposition that for a justiciable controversy to exist, *Aspex* must reinstitute manufacture and sale of the [disputed product] before it can test the patent, and risk being held a willful infringer subject to treble damages if the test fails, raises a question for which *MedImmune* counsels thoughtful review of the entirety of the circumstances. *Aspex* maintains that it has the right to make and sell the disputed eyewear products because the ‘913 patent is invalid or unenforceable. The planned activity is not speculative. . . . Thus, *Aspex*’s declaratory action is not a request for an ‘advisory opinion’ sought by a would-be future competitor; it meets the *MedImmune* requirement of ‘sufficient immediacy and reality,’ when the entirety of the circumstances are considered.”) (citation omitted)).

covenant not to sue covered past and current products.⁹⁹ Thus, a reasonable apprehension was no longer present because Amana could not be subject to litigation after the covenant not to sue was signed.¹⁰⁰

Based on the dicta in the *SanDisk* and *Revolution* opinions, it is highly possible that *Amana* would have been decided differently for a number of reasons. First, based on the facts of *Amana*, the declaratory judgment plaintiff indicated that it believed an actual controversy still existed with regard to its products that were “in the pipeline.”¹⁰¹ These were products planned by the company that had not yet been manufactured or advertised and were therefore not covered by the covenant not to sue.¹⁰² Additionally, the patentee had notified distributors that it was terminating their agreements because of their relationship with Amana.¹⁰³ This is an additional factor indicating the adverse relationship between the two parties. Under the new declaratory judgment standard, the totality of the circumstances must be taken into account.¹⁰⁴ Therefore, the covenant not to sue would not have the same conclusive effect now that it did under the reasonable-apprehension test. Under the new standard, it is highly plausible that the court could decide that under the totality of the circumstances (i.e., consideration of the adverse relationship of the two parties and the pipeline products), an actual controversy continues to exist, even though a covenant not to sue was filed by the patentee. Of course, this analysis is speculative, and it is also possible that the Federal Circuit would reach a similar result in the *Amana* case under the new totality of the circumstances test.

Although it would not be completely surprising if the Federal Circuit were to find that the covenant not to sue in *Amana* eliminated the actual controversy, under the new totality of the circumstances test, there are strong arguments against the court reaching such a result. Specifically, Amana’s contention that the covenant not to sue did not cover products it had in its pipeline should be given substantial weight in determining the presence of an actual controversy. The *SanDisk* decision stated that

where a patentee asserts rights under a patent based on certain identified ongoing or *planned activity* of another party, and where that party contends that it has the right to engage in the accused activity without license, an Article III case or controversy will arise and the

99. *Amana*, 172 F.3d at 855.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007) (citing *Md. Cas. Co. v. Pac. Coal & Oil Co.*, 312 U.S. 270, 273 (1941)).

party need not risk a suit for infringement by engaging in the identified activity before seeking a declaration of its legal rights.¹⁰⁵

The *SanDisk* dicta indicate that the Federal Circuit has interpreted the Supreme Court to accept the proposition that an actual controversy can exist even when the allegedly-infringing party is only *planning* to conduct the infringing activity.¹⁰⁶ However, the dicta in *SanDisk* and *Revolution* only address the specific situation in which the patentee has asserted its patent rights against the planned activity of another party, and does not address the same situation present in *Amana*. The hypothetical below should shed light on the facts of the *Amana* scenario, but in broader terms.

Imagine the hypothetical scenario in which the patentee asserts its patent rights against the alleged infringer for product X. The alleged infringer then files a declaratory judgment suit for noninfringement against the patentee. To avoid litigation, the patentee then signs a covenant not to sue and promises not to assert its patent rights for any past or present products marketed by the alleged infringer. Unbeknownst to the patentee, the alleged infringer has product X2 in the pipeline. Because X2 is in the pipeline, the alleged infringer wishes to continue its declaratory judgment suit for noninfringement to open up the avenue for future marketing of this pipeline product.

The *MedImmune* dicta can be applied to the hypothetical scenario in both a broad and narrow way. Under the narrow application, an actual controversy would not exist because the patentee did not assert its patent rights against the planned activity of X2. This narrow interpretation of the dicta in *MedImmune* would lead to the same result as the court reached in the *Amana* decision. If, on the other hand, courts interpret the language in the *MedImmune* decision more broadly, a different result may follow. Courts could interpret the language of the decision to mean that an actual controversy exists even for the planned activity of the alleged infringer. Specifically, in the scenario where the patentee has asserted its rights for one activity, it seems likely that the patentee would assert its rights for similar activity later down the line.¹⁰⁷ Therefore, in determining if an actual controversy exists, a court should find little relevance in the patentee's limited awareness of only one of the ongoing activities or planned activities when writing its initial brief to the court.

105. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1381 (Fed. Cir. 2007) (emphasis added).

106. 549 U.S. at 132.

107. One counterargument to this reasoning is that if the party settled with a covenant not to sue for the current infringing product, then it would be likely to sign an additional covenant not to sue for the later product, if the situation did arise. This may be true, but the alleged infringer has the right to establish its legal status via court opinion.

This type of broad interpretation of the *MedImmune* dicta has important policy implications, specifically in the context of pipeline inventions. First, it is likely that if a company is already in the field of producing product X, its later generation X2 and X3 would also likely be covered by the patentee's patent that covered product X. Thus, it would be beneficial for the allegedly-infringing company to have the declaratory judgment suit heard at its initial filing and not postponed until a later time. If the courts adopt this type of approach, they will help clear the legal cloud over the allegedly-infringing company and thus improve its marketability for investors and its potential for growth. These important policy considerations, which when taken into account with the policy arguments in Part III of this Note, support the notion that in certain situations, a covenant not to sue for past and present activity may not suffice to eliminate an actual controversy if there are pipeline products.

Nonetheless, this type of consideration is not free of criticism.¹⁰⁸ An important factor in analyzing these so-called pipeline products is the allegedly-infringing company's level of investment into product X2. Is product X2 a completely speculative product or has the company already invested resources in the development of this future product? This would require a factual inquiry into the business of the allegedly-infringing company and thus require more time and resources from the court system. However, the courts could avoid bearing the extra burden of the factual inquiry by placing the onus of providing the factual records on the party asserting that it intends to release product X2 in the future. By placing the burden on the allegedly-infringing company, the infringing party would have to consider whether or not the continuation of the declaratory judgment litigation was really in its favor. Intuitively, it seems that if the allegedly-infringing company believes that it should continue pursuing its declaratory judgment suit because of pipeline products, then a covenant not to sue provided by the patentee should not prevent the alleged infringer from having its legal rights ascertained by the court.¹⁰⁹

108. Another criticism of an easier declaratory judgment standard is that it requires additional litigation in general, which requires additional resources from the court system.

109. The hypothetical scenario discussed above can be further developed by adding an additional caveat. Imagine that the alleged infringer, who wishes to continue litigation on its pipeline product, sends a letter to the patentee stating that it will continue to develop and eventually sell pipeline products X2 and X3. By sending such a letter the alleged infringer would provide tangible evidence that an actual controversy continues to exist even if a covenant not to sue covering the current products has been signed. This variation of the hypothetical is distinct from the original hypothetical, and courts may be more inclined to find that an actual controversy continues to exist. However, the fundamental analysis of the immediacy of the actual controversy would still be applied, and courts could still find this letter of intent insufficient to maintain the actual controversy.

III. THE NEW DECLARATORY JUDGMENT STANDARD AND ITS IMPACT ON LICENSING AGREEMENTS

A. PURIFYING THE PATENT SYSTEM OF INVALID PATENTS

The new declaratory judgment standard adopted by the Federal Circuit as a result of *MedImmune* will have an impact on the license negotiation field.¹¹⁰ A number of commentators have indicated disapproval of the new standard and have explained that the new more lax standard for establishing jurisdiction in declaratory judgment actions will lead to difficulty in patent license negotiations.¹¹¹ These articles argue that companies will not be able to negotiate the terms of license agreements because they will have to worry about the consequences of a declaratory judgment suit that could lead to the invalidity of their patents.¹¹² These arguments are more convincing in light of the patent landscape in recent years. After the Supreme Court's decision in *KSR International, Co. v. Teleflex, Inc.*,¹¹³ prior-art searches have made proving invalidity of patents via obviousness arguments much more prevalent.¹¹⁴ This has further resulted in many patents being found invalid.¹¹⁵ Some scholars have argued that the company with the greatest amount of resources will triumph by conducting more in-depth prior-art searches.¹¹⁶ Under a more lax standard for jurisdiction, these companies will have to worry that their patents will be subjected to invalidity suits, which are becoming ever more successful in recent years.¹¹⁷ Therefore,

110. "[T]he rule adopted by the court in this case will effect a sweeping change in our law regarding declaratory judgment jurisdiction. . . . I agree with the court that a fair reading of footnote 11 of the Supreme Court's opinion in *MedImmune* compels that result. . . ." *SanDisk Corp. v. STMicroelectronics, Inc.* 480 F.3d 1372, 1385 (Fed. Cir. 2007) (Bryson, J., concurring).

111. See, e.g., Helm & Lee, *supra* note 15, at 245; Saionz, *supra* note 15, at 192.

112. *Supra* note 111.

113. *KSR Int'l Co. v. Teleflex, Inc.*, 550 U.S. 398, 415–22 (2007).

114. Keith L. Slenkovich, *The Changing Landscape of Obviousness in the Wake of KSR*, in 2ND ANNUAL PATENT LAW INSTITUTE, at 431 (PLI Patents, Copyrights, Trademarks, & Literary Prop. Course Handbook Series No. 14506, 2008) ("[T]he KSR decision appears to have had a meaningful impact of increasing determinations of patent obviousness [in bench trials].").

115. Harold C. Wegner, *Making Sense of KSR and Other Recent Patent Cases*, 106 MICH. L. REV. FIRST IMPRESSIONS 39, 41, <http://www.michiganlawreview.org/firstimpressions/vol106/wegner.pdf> ("As a result [of KSR], inventions that were nonobvious the day before KSR suddenly became obvious to this modern man of ordinary skill in the art.").

116. "A rough estimate may be that half of the cost of patent litigation—\$1.05 billion per year—is attributable to disputes over the validity or enforceability due to inequitable conduct of the patents in suit," Mark A. Lemley, *Rational Ignorance at the Patent Office*, 95 NW. U. L. REV. 1495, 1503 (2001). Since a validity dispute will in most cases involve prior art searches, one can conclude that a party with "deeper pockets" will have more success in such disputes because of the high costs attributable to this aspect of patent litigation.

117. Lee Petherbridge & R. Polk Wagner, *The Federal Circuit and Patentability: An Empirical Assessment of the Law of Obviousness*, 85 TEX. L. REV. 2051, 2055 (2007) ("The Federal Circuit finds patents obvious a clear majority of the time. Overall, about 58% of all analyses result in a finding of

these companies will be more hesitant to obtain license agreements from infringers and will thus make less profit off of their patents. The downstream effect of such a practice is that patents as a whole will become less valuable because companies will be more reluctant to try to obtain licenses.

However, this line of argument is open to objection on a number of grounds. First, one can argue that it is for the benefit of the patent system that it be easier to obtain jurisdiction under a declaratory judgment standard. One line of reasoning in favor of a more lax declaratory judgment standard in the patent context is that it will encourage the purification of the patent system.¹¹⁸ By providing alleged infringers with the right to assert their legal rights and challenge the infringement suit, the new declaratory judgment standard has made it possible for the infringers to also challenge the validity of the patent. Then, if a patent is not actually valid, the patent system will be purged of these invalid patents (whether for obviousness or on other grounds).

In support of the argument that these post-*MedImmune* standards will purify the patent system, one should also take into account the following: Under the new declaratory judgment standard, it is easier for an alleged infringer to bring an invalidity suit against the patentee. Therefore, a patentee will only assert its rights if it is certain that it has a valid patent. Thus, the argument that companies will be hesitant to enter licensing negotiations does not apply to all situations, since individuals who know that they have valid or relatively strong patents will not be wary of potential invalidity suits. Additionally, the actual patent statute indicates that a patent is presumed valid.¹¹⁹

B. FOUR BARGAINING SCENARIOS: AN ANALYSIS OF EXPOSED REVENUES AND BURDENSOME LITIGATION COSTS

The final portion of this Note will present four potential bargaining scenarios that may arise. For simplicity's sake, the hypothetical scenarios will assume only two types of companies: large companies and small companies.¹²⁰ Assuming only these two types of companies, there are four potential bargaining scenarios. Under the first scenario, a large company patentee attempts to license the invention to a small company. Under the second scenario, two large companies are negotiating a licensing agreement. Under the third scenario, a small company patentee attempts

obviousness; this trend has been increasing since 1990. This ratio does not seem to be associated with broad technological areas.”).

118. See Helm & Lee, *supra* note 15, at 231.

119. See 35 U.S.C. § 282 (2006).

120. Large companies are assumed to have substantially greater financial resources than small companies.

to license the invention to a large company. Finally, under the fourth scenario, two small companies are negotiating a licensing agreement.

The breakdown of the bargaining parties into these two groups is important for the final analysis of the new, more lax declaratory judgment standard. In undertaking this four-scenario analysis, two factors must be considered simultaneously. First, one must consider the issue of exposed revenues (i.e., the value of the business enterprise and how deep its pockets are). This Note discusses and applies this factor in greater detail below. Second, one must consider the issue of burdensome litigation costs and the ability of a large company to overwhelm a smaller company with exorbitant legal fees. These two factors may swing in different directions depending on the parties involved in the hypothetical license negotiation.

Under scenario one (large company patentee and small company licensee), the main benefit from the more lax declaratory judgment standard comes from an analysis of exposed revenues. Hypothetically speaking, a more established company will have a larger patent portfolio, more robust exposed revenues than a smaller company, and, consequently, more to lose. In light of the more lax declaratory judgment standard, patentees with greater exposed revenue may become more hesitant to assert their patent rights, since companies now have a greater risk of losing their patents. On the other hand, companies will likely assert their patent rights against companies that have large exposed revenue because then the patentees will have the opportunity to generate the greatest revenue from a licensing agreement. Basically, a company would rather assert its patent rights to gain a license from a large company like the maker of Blackberry¹²¹ than against a smaller company which no one has heard of and does not yet sell its product on the market. The answer seems clear. Under the more lax declaratory judgment standard, larger companies will have to make a careful cost-benefit analysis before they assert their patent rights because they have more exposed revenue to lose. Additionally, patentees will likely refrain from asserting their patent rights against smaller companies because these smaller companies have less money to pay under licensing agreements and because the larger companies would rather minimize exposing risk to their patents.

Now imagine the hypothetical scenario of two large companies (scenario two). Large company A ("MacroSoft") believes that large company B ("Max") is infringing its patent and sends Max a letter indicating interest in setting up a license agreement.¹²² Max could

121. See, e.g., *NTP, Inc. v. Research in Motion, Ltd.*, 418 F.3d 1282, 1290–91 (Fed. Cir. 2005).

122. IBM makes over \$1 billion a year in patent licensing royalties and has made it a company

proceed to establish jurisdiction under the new declaratory judgment standard and attempt to prove the invalidity of the asserted patent. However, as a result of being a larger company, Max will likely have a more robust patent portfolio and greater exposed revenue than a smaller company. The combination of more exposed revenue and a more robust patent portfolio makes the chance of a cross-license agreement between MacroSoft and Max more likely than a cross-license agreement between MacroSoft and a smaller company. The reason for this should be obvious: Max likely has more relevant patents than a smaller company and therefore will have more leverage. Furthermore, Max will be more hesitant to go to court and risk losing its noninfringement law suit. In conclusion, in scenarios like this one, it is more likely that a large company would avoid a declaratory judgment suit because it would have more robust exposed revenue and thus would not want to go into court and risk its exposed revenue, when it can reach a cross-license agreement.¹²³

Although an analysis of the first two scenarios indicates that the more lax declaratory judgment standard may have a favorable impact on certain situations, the analysis of scenario three provides a much different result. In scenario three, a small company holds a patent, and a larger company is conducting allegedly-infringing activity. In this scenario the issue of burdensome litigation truly rears its ugly head. Imagine the following situation: a small company called Startup has promising intellectual property but only limited funding to begin its business. A large company called MacroSoft is conducting activity that may infringe on Startup's intellectual property. If Startup attempts to negotiate a licensing agreement with MacroSoft, then under the more lax declaratory judgment standard, Startup is at a much higher risk of a declaratory judgment suit. This is further complicated by the issue of burdensome litigation. Since MacroSoft has potentially limitless funds compared to Startup, MacroSoft can pursue a declaratory judgment suit and finance the litigation without too much of an effort.¹²⁴ However,

policy to obtain patents for the specific purpose of licensing them out. See KEVIN G. RIVETTE & DAVID KLINE, *REMBRANDTS IN THE ATTIC: UNLOCKING THE HIDDEN VALUE OF PATENTS* 58 (2000).

123. This Note does not discuss hypothetical scenario four involving negotiations between two small companies in detail. A similar analysis as applied to two large company negotiations can be applied to the smaller company scenario since both parties are in an equal bargaining position with regard to finances for litigation and exposed revenue. Both parties have little exposed revenue and are therefore unfavorable potential licensees. More specifically, the minimal revenue generation of the small company functions as a disincentive because the maximum net royalty payments are limited by the net sales of the small company.

124. "The American Intellectual Property Law Association reports, based on a survey of its members, that the median cost of patent litigation to each side is \$799,000 through the end of discovery, and \$1,503,000 through trial and appeal." Lemley, *supra* note 116, at 1502.

Startup will have to divert its more limited and hence more valuable finances to defending its intellectual property. As a result, Startup may be more inclined to drop the licensing negotiation with MacroSoft out of fear of the burdensome litigation costs. This scenario puts Startup at a disadvantage because Startup will not be able to monetize its intellectual property through licensing agreements with larger companies because of fear of declaratory judgment litigation.

As these observations illustrate, the new declaratory judgment standard leaves the court system in a better situation in certain scenarios but not in others. The hypothetical MacroSoft will be more hesitant to assert its patent rights against smaller companies that have less exposed revenue. This makes sense because as discussed earlier, a smaller company has a less robust patent portfolio, less exposed revenue, and therefore provides less economic benefit to MacroSoft (while providing a similar risk for a declaratory judgment suit). Similarly, the new standard leaves smaller companies in a worse scenario when it comes to licensing their inventions. As explored under the burdensome-litigation factor, smaller companies may become more hesitant to enter licensing negotiations with larger companies because of the risk of unwieldy litigation costs. Consequently, the more lax declaratory judgment standard puts licensors generally, whether large or small, in a more difficult position.

Although this lax declaratory judgment standard seems to put small licensors in an even more precarious situation than large licensors because of the potential to overwhelm the small licensor with litigation fees, this more lax standard still favors the smaller company. The primary objective of a small company is not to monetize its intellectual property through an aggressive licensing plan, but rather to develop a product either independently or through the friendly licensing of its intellectual property with an interested larger company. For example, a common practice in the biotechnology industry is that in which many small companies develop products at the cutting edge of science and then license the intellectual property to a large company that will help commercially develop the product (commonly through joint venture agreements). Since this is the primary objective of small companies, the fact that they may have difficulties attempting to aggressively license their intellectual property should not weigh against the new declaratory judgment standard. Rather, this shift of power will likely have the greatest impact on patent troll companies, euphemistically referred to as "license-holding companies." It is these types of companies that will feel the greatest brunt of the new standard because the new declaratory judgment standard puts licensors generally in a more vulnerable position. Since the primary business objective of the license-holding companies is

to aggressively license their intellectual property, they will consequently feel the greatest impact from the new standard.

CONCLUSION

The new patent licensing arena will enable smaller companies to function with less fear of trivial licensing agreements. These smaller companies will have less to fear because the new ease in establishing declaratory judgment jurisdiction will ensure that larger companies, like MacroSoft, do not assert their patent rights until there is sufficient incentive to expose MacroSoft's patent to the risk of invalidity. Additionally, license-holding companies will have less strength in their licensing negotiations because of the risk of a declaratory judgment suit. In the bigger picture, this may help smaller companies budget their resources more efficiently, since they will not have to pay as many onerous licensing fees. This will inevitably benefit the marketplace, since competition and variety will ideally lead to greater innovation. The new declaratory judgment standard may not only help purge the patent system of invalid patents, but may also foster the development of smaller companies and increase diversity in the world of technology companies. In conclusion, if companies' primary purpose is developing technology, as opposed to generating revenue through an aggressive licensing plan, then the new declaratory judgment standard will help such companies operate without fear of faulty license demands.
